Responsible Investment Report

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HIGHLIGHTS

01 In 2011, the Caisse exercised its voting rights at 4,890 shareholder meetings.

02 The Caisse helped implement Concordia University's Sustainable Investment Professional Certification Program.

03 The Caisse participated in a number of conferences to explain its responsible investment approach.

PRACTICING RESPONSIBLE INVESTMENT MANAGEMENT

The Caisse's mission is to receive moneys on deposit as provided by law and manage them with a view to achieving optimal return on capital within the framework of depositors' investment policies while at the same time contributing to Québec's economic development. The Caisse takes two approaches to investing: active, by selecting public companies and investing in private equity, infrastructure or real estate, or passive, by investing to model the composition of the market indexes in order to reproduce their returns.

In its active investing, the Caisse promotes responsible investment in many ways. It begins by analyzing environmental, social and governance factors, the non-financial dimensions and risks of an investment known as ESG. Moreover, it encourages sound corporate governance practices. The Caisse's approach is defined in the Policy on Responsible Investment available on its website (www.lacaisse.com).

PROACTIVE ENGAGEMENT FOR MANY YEARS

The Caisse ushered in a responsible investment approach in 1994 with the systematic exercise of voting rights in public companies. In 2005, following a benchmarking exercise conducted among its peers, the Caisse adopted the Policy on Responsible Investment, which was updated in 2010.

A signatory of the UN Principles for Responsible Investment (PRI), the Caisse incorporates these principles into its approach. The PRI were launched in 2006 in cooperation with major asset holders and managers, including the Caisse.

THE CAISSE'S RESPONSIBLE INVESTMENT APPROACH

As one of Canada's largest institutional investors, the Caisse has many resources on hand to influence companies' social responsibility, environmental and governance practices.

Its approach takes account of returns on depositors' funds and their expectations, notably in terms of risk and responsible investment.

As an institutional investor, the Caisse occasionally invests in sectors considered controversial. In such cases, the Caisse applies the approach set out in its Policy on Responsible Investment. This policy is structured along the following lines:

1. Shareholder engagement
Shareholder engagement activities take shape through the Caisse's proactive dialogue with companies, independently or in collaboration with investor groups, to improve the level of information available about the companies in which it invests and to influence their responsible business practices. The Caisse's shareholder engagement activities also include the systematic exercise of its voting rights at shareholder meetings.

2. Environmental, social and governance (ESG) criteria
ESG criteria are integrated into the overall analysis of actively managed investments.

3. Exclusions
Although shareholder dialogue and engagement remain the primary tools of its Policy on Responsible Investment, the Caisse may exclude from its actively managed portfolio, if exceptional circumstances warrant it, securities in violation of local or international law. These matters are reviewed by an internal committee made up of employees from different sectors, including investment sectors.

Table 50 describes the structure of the Caisse's responsible development approach.

2011 RESPONSIBLE INVESTMENT REPORT

In addition to exercising voting rights and dialoguing with companies, the Caisse was involved in numerous activities in 2011, including implementing a training program with Concordia University, launching a research program with a Université de Sherbrooke professor and holding meetings with depositors on responsible investment. The Caisse also attended conferences on responsible investment and organized activities with groups such as the Canadian Coalition for Good Governance, and with other investors.

In 2011, the Caisse also took action based on the three prongs of its Policy on Responsible Investment.

1. SHAREHOLDER ENGAGEMENT

As per its policy, the Caisse positions itself as a partner, working with companies and helping them improve their social responsibility in various ways.

In its responsible investment approach, the Caisse interacts with companies to obtain information more relevant to all shareholders. Through shareholder engagement, the Caisse expresses its views and positions on ESG-related issues or problems. It usually communicates privately with companies, this being a more effective approach. Accordingly, the Caisse generally does not disclose the names of companies with which it has communicated.

Certain investment sectors in which the Caisse is prominent present significant shareholder engagement challenges when it comes to responsible investment principles. One example is natural resources. The Caisse is confident that its influence and willingness to cooperate with companies in these sectors bring about improvements in terms of the environment, more efficient technologies and respect for communities.

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THE CAISSE'S RESPONSIBLE INVESTMENT APPROACH

Vision	The Caisse is a responsible shareholder and acts in a fiduciary spirit to provide risk-adjusted, long-term returns.
Policies	Policy on Responsible Investment Policy on the Principles Governing the Exercise of Voting Rights of Public Companies
Approach	Shareholder engagement ESG criteria Exclusions
Activities	Voting rights Direct dialogue Collaborative initiatives Dialogue between stakeholders and industry Risk analysis Research Review of individual cases

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At the beginning of 2011, the Caisse identified shareholder engagement themes concerning which it planned to take action or initiate dialogue with portfolio companies. The themes were chosen based on the following criteria:

- ESG risk analysis by sector and exposure to risks defined as significant in portfolio investments;
- the ability to intervene and potential levers for dialogue with companies, either directly or through groups.

From the identified themes, shareholder engagement activities in 2011 focused primarily on environmental and social issues associated with natural resource use, governance and water.

1.1 Shareholder engagement through the exercise of voting rights

Each year, the Caisse analyzes all proposals tabled at the shareholder meetings of public companies in its portfolios.

An internal team exercises voting rights at the shareholder meetings of Canadian and U.S. companies. For international companies, votes are exercised by an external supplier in accordance with the Caisse's policies and guidelines. All voting positions for Canadian and U.S. companies are published on the Caisse's website (www.lacaisse.com).

For shareholder meetings of international companies, the internal team ensures that the supplier votes in accordance with the Caisse's policies.

2011 voting report

Below are the highlights for 2011 regarding the exercising of voting rights.

The Caisse voted on 48,001 proposals at 4,890 shareholder meetings.

- Canada: 205 meetings
- United States: 717 meetings
- International: 3,968 meetings

12% of the Caisse's total votes in 2011 were against management proposals.

- 8%: Canada
- 12%: United States
- 12%: International

Votes on management proposals

Most proposals at shareholder meetings are submitted by the company's management and are related to the election of directors, the appointment of auditors or other matters that arise in the normal course of business.

Although the Caisse usually supports management recommendations, it will sometimes oppose them. Table 51 provides examples of such opposition in Canada and the United States.

TABLE 51

EXAMPLES FOR OPPOSITION

Types of management resolutions	Number of resolutions AGAINST	Reasons
CONSULTATIVE VOTE ON EXECUTIVE COMPENSATION	Out of a total of 718 resolutions presented, the Caisse voted against management in 11% of cases.	Compensation is not linked to the company's performance or the disclosures made by the company are incomplete.
ELECTION OF DIRECTORS	Out of a total of 6,688 resolutions, the Caisse voted against management in 7% of cases.	The Board of Directors is not composed of a majority of independent directors.

Votes on shareholder proposals
Shareholder proposals submitted at meetings are reviewed and analyzed on a case-by-case basis. In 2011, the Caisse voted on 435 shareholder proposals at meetings of Canadian and U.S. companies, and supported 325 of these proposals.

Table 52 (p. 96) provides examples of shareholder proposals reviewed by the Caisse in 2011.

EXAMPLES OF POSITIONS TAKEN BY THE CAISSE

Sustainable development report
The Caisse supports resolutions requiring companies to produce a sustainable development report, if they are not already doing so. The Caisse expects companies to behave responsibly wherever they operate. With this in mind, it encourages disclosure of the environmental and social practices of companies.

Board diversity
The Caisse supports resolutions to improve parity on boards of directors. It supports measures to broaden the pool of individuals qualified and competent to stand for election as directors.

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EXAMPLES OF SHAREHOLDER PROPOSALS SUPPORTED BY THE CAISSE IN 2011

Resolutions	FOR Votes	FOR Vote Reasons	Company Examples	AGAINST Vote Reasons
Periodic report on political contributions	39 out of 42 proposals (93%)	The proposal calls for the full and transparent disclosure of company practices regarding political contributions.	Boeing Co. Citigroup Inc. 3M Company	The company is making the necessary efforts to disclose all of its political contributions.
Give shareholders the right to call a special meeting under some conditions	27 out of 27 proposals (100%)	The proposal gives shareholders a stronger voice.	American Express Co. PepsiCo Inc. Home Depot of Canada Inc.	N/A
Separation of Board Chairman and Chief Executive Officer positions	16 out of 26 proposals (62%)	The Board did not appoint an independent director to act as lead director and ensure effective work progress.	Boeing Co. Wells Fargo & Company Whole Foods Market, Inc.	The Board appointed an independent director to act as lead director and ensure effective work progress.
Election of directors by majority vote	24 out of 24 proposals (100%)	Electing directors by majority vote gives shareholders a stronger voice.	Apple Caterpillar Inc. Lorillard Inc.	N/A
Annual election of directors	23 out of 23 proposals (100%)	The annual election process makes it possible to periodically assess all directors.	Best Buy Co. Mcdonald's Corporation Western Union Co.	N/A
Cumulative vote	19 out of 19 proposals (100%)	The principle of proportionate representation in investments by way of cumulative voting gives shareholders a stronger voice in the election of directors.	Goldman Sachs Group, Inc. Home Depot of Canada Inc. Wells Fargo & Company	N/A
Majority vote for various issues	12 out of 12 proposals (100%)	An absolute majority vote should be sufficient to approve changes in corporate governance.	Google Inc. Netflix Inc. Southwest Airlines Co.	N/A
Sustainable development report	7 out of 8 proposals (88%)	The company does not disclose sufficient information on environmental or social issues.	SunTrust Banks, Inc. Southern Union Co. Boston Properties, Inc.	The company's commitments address concerns raised in the proposal.

1.2 Shareholder engagement through direct dialogue with companies

The Caisse carries on a direct dialogue with its portfolio companies in many ways, for instance, by exercising its vote in order to obtain more information, making its voting position known to companies, or identifying specific concerns.

The Caisse holds a direct dialogue mainly with companies on the Canadian market and a few international companies. All Canadian public companies in the Caisse's actively managed portfolio were contacted during 2011, either as part of its process of making companies aware of the importance of completing the Carbon Disclosure Project questionnaire for greenhouse gas reporting, or at shareholder meetings or at meetings with the Caisse's managers or analysts. ESG issues were regularly addressed at these meetings for purposes of reviewing the company's ESG practices, or discussing a specific matter in which the Caisse hoped to see improvement.

Many engagement activities with companies took place outside shareholder meetings. Mining and natural resource companies were targeted in connection with shareholder engagement priorities defined at the beginning of 2011. We visited operating sites to check points that had been discussed or to initiate dialogue.

On the whole, we noted improved environmental and social disclosure in companies with which the Caisse had opened dialogue, along with greater awareness and prioritization of such issues. Practical steps were taken to improve community relations and mitigate the environmental impact of operations.

For example, seven companies with tar sands operations formed a partnership to pool technology developed to reduce the environmental impacts of settling basins (sedimentation). The same companies also announced a future joint initiative related to water, greenhouse gas and territorial claims issues. The Caisse discussed these issues with most of these companies.

EXAMPLES OF DIALOGUE WITH COMPANIES

Director participation in compensation plans

The Caisse is generally in favour of limiting director participation in stock-based compensation plans. The number of share grants must be less than 1% of the outstanding shares. The Caisse noticed that a company's directors could participate in this kind of plan on a discretionary basis. The company was contacted and it was agreed that, to preserve director independence, its compensation committee would limit director participation.

Quorum

A company's bylaws stated that the board of directors was empowered to set the required quorum for directors' meetings. The Caisse expects the majority of directors to be the quorum for meetings. Moreover, the quorum for shareholder meetings was set at one person holding at least 10% of the votes. The Caisse expects the quorum to be reached when at least two people holding more than 25% of the votes are present or represented. The Caisse contacted the company, which confirmed that, in practice, the majority of directors constituted the quorum at meetings. The company also agreed to increase the shareholder meeting quorum at the next meeting.

Suncor

The Caisse established a sustained dialogue with Suncor and commends its environmental initiatives, which the Caisse encouraged. Suncor immediately qualified for the three responsible investment indexes – Dow Jones Sustainability Index, Jantzi Social Index and FTSE4Good Index – in addition to ranking first in 2011 in the Carbon Disclosure Project's Carbon Disclosure Leadership Index for the quality of its greenhouse gas emission disclosure. Notably, Suncor developed an innovative and award-winning* tailings management process (TRO™) to significantly improve the speed of tailings reclamation, thereby reducing environmental impacts. Embarking on this unprecedented collaborative process, Suncor shared this technology – a noteworthy accomplishment in this industry – with six companies as part of a research-sharing agreement.

* ASTech 2010 award
Alberta Science and Technology Leadership Foundation)

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EXAMPLES OF DIALOGUE WITH COMPANIES (CONTINUED)

Social measures in a conflict area
After visiting the operations of a company located in an area of political conflict and violence, the Caisse initiated a dialogue on implementing measures to smoothly integrate the company's operations into community life. This essentially led to a multi-faceted, local public health and education program.

In 2011, for instance, the company launched a new student program to improve academic performance along with a program to identify students most likely to succeed at university. Security for inhabitants in the operations area was another social measure that was put in place. The company implemented a communications system enabling it to quickly respond to security incidents in the operations area.

Lastly, a relationship with a NGO was followed up after the NGO criticized the company's practices the previous year. At the request of several shareholders, including the Caisse, a dialogue was begun with the NGO in question.

1.3 Shareholder engagement through joint initiatives with companies

The Caisse is involved in many shareholder engagement activities with other investors.

In 2011, the Caisse participated in a local initiative launched by *CDP Water Disclosure* of the *Carbon Disclosure Project*, combining 354 investors worldwide, to send a letter to 425 large-cap companies. The companies were asked to answer a questionnaire on management of water issues, including water policies and strategies, geographic area of company operations, risk indicators, operational risk management, financial impacts related to water issues, measurement of recycled, reused or wasted water during operations, and intensity measurements. The results showed a definite interest in water issues and are rather good for an initiative that is only in its second year. The response rates were:

- 60% of invitees from the Global 500;
- 41% of invitees from the ASX 100 in Australia;
- 46% of invitees from the JSE 100 in South Africa.

The main findings showed that:

- 63% of the Global 500 respondents identified opportunities for more effective water management, or cost reductions;
- the percentage of Global 500 respondents that reported recycled, reused or wasted water measurements was higher than in 2010;
- the energy sector had the lowest response rate (Global 500).

Along the same lines, the Caisse participated, as it has for some years now, in the *Carbon Disclosure Project*, an organization that brings together 551 investors worldwide and urges companies to answer a questionnaire on greenhouse gas issues, seeking disclosure on related governance measures (staff objectives associated with these issues, level of responsibility for these issues within the company), strategy, reduction targets and ways to achieve them, climate change business risks/opportunities and methodology for calculating different types of emissions.

Investors can use this information to obtain a clearer and more detailed snapshot of climate change risks and implemented initiatives, and then estimate the associated financial impacts.

1.4 Shareholder engagement through dialogue with stakeholders

The Caisse is involved in many groups that work to maintain ongoing dialogue with companies and stakeholders:

- UN Principles for Responsible Investment (PRI)
- Carbon Disclosure Project
- CDP Water Disclosure
- Canadian Coalition for Good Governance
- Pension Investment Association of Canada
- International Corporate Governance Network
- Extractive Industry Transparency Initiative (EITI)
- Social Investment Organization (Canada)
- Hedge Fund Standards Board (HFSB)

In 2011, the Caisse took part in many activities within these groups, including:

- Governance Committee of the Pension Investment Association of Canada;
- PRI task force on integrating these principles into corporate bonds;
- Canadian Advisory Group of the Carbon Disclosure Project;
- Pension fund group of the Social Investment Organization.

THE CAISSE ON THE BOARD OF DIRECTORS OF THE HEDGE FUND STANDARDS BOARD (HSFB)

Integrating ESG criteria into hedge funds is a challenge. Governance and transparency are key criteria in analyzing the choice of fund managers. Integration is achieved primarily through a strict due diligence process incorporating these criteria.

The HSFB is a hedge fund governance standardization agency. It aims to provide a framework of transparency, integrity and good governance in order to maintain a good reputation for the industry and facilitate investor due diligence, in the interests of all market participants.

The Caisse also participates in stakeholder committees set up by companies to fuel discussion about ESG issues and elicit a wide range of perspectives. In 2011, the Caisse was represented on five such corporate committees.

2. INTEGRATING ESG CRITERIA

ESG factors are integrated into investment and risk analyses to varying degrees and in different ways depending on the asset class. This approach allows for some flexibility in implementing ESG factors, based on the investment's reality.

ESG integration is firmly entrenched in the equity market sector, primarily for the Canadian market. Over the years, tools have been developed to enable managers to incorporate ESG criteria into their analyses. Managers closely monitor these factors for any impact on their portfolios. ESG continued to be integrated in 2011, mainly for the U.S. market. Note that ESG factors are primarily used in active management. For indexed management, the Caisse relies on the exercise of its voting rights and, to a lesser extent and in collaboration with other investors, on shareholder engagement.

For private equity, ESG factors are considered in investment analyses and captured in the due diligence process.

In fixed income, ESG factors are integrated into the corporate bonds sector. The Caisse is now implementing an approach similar to the equity markets approach, adjusting it as necessary to the reality of the bond market. To facilitate and complement its efforts to integrate this asset class, the Caisse participates in the PRI task force that analyzes corporate bond-related ESG risks.

SEIGNEURIE DE BEAUPRÉ WIND FARMS

The Caisse provided $25 million to finance phase one of the Seigneurie de Beaupré wind farms in the Québec City region. The wind farms' annual production should cover the power requirements of some 50,000 homes.

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Research is also a key component of ESG integration. The Caisse encourages ESG research, primarily by requesting securities brokers to provide reports incorporating an ESG analysis, subscribing to the services of specialized research firms and attending ESG conferences. Integrating ESG factors into the core analysis of an investment is so important that the Caisse regularly works with universities on this kind of work. In this respect, it established the following partnerships in 2011:

- Implementation of a Sustainable Investment Professional Certification Program at Concordia University.
- Research partnership with Université de Sherbrooke for a study on new financial indicators including ESG factors and a study on how these factors impact companies.

3. EXCLUSIONS

Excluding securities from portfolios is an exceptional measure that the Caisse takes in special circumstances. If circumstances warrant, the Caisse can exclude from its actively managed portfolio securities for which there is a breach of local or international law. An internal committee composed of employees from different sectors, including investment sectors, reviews these issues.

The Caisse excludes from its portfolio companies that manufacture weapons banned by the Ottawa Convention Banning Landmines and the Oslo Convention on Cluster Munitions. These securities could be reinstated, however, if the companies in question stopped manufacturing such weapons.

RESPONSIBLE INVESTMENT COMMITTEE

The Responsible Investment Committee was set up in early 2011. Its role is to review the broad responsible investment themes. It must also review the following matters:

- Key subjects on the Caisse's shareholder engagement
- Exclusion issues

The Responsible Investment Committee, which brings together representatives from the different asset classes the Caisse invests in, met four times in 2011.

DEVELOPMENTS AND TRENDS

The Caisse regularly tracks market developments and trends in responsible investment. It specifically monitors changes in governance practices, both at a regulatory level and in best practices, so as to take them into account in its voting positions. Lastly, the Caisse occasionally participates in consultations held by the Canadian Securities Administrators on the disclosure requirements of public companies, so that shareholders will have comprehensive, transparent information on the main risks and compensation practices of companies.

In 2011, regulatory bodies positioned themselves, notably with respect to disclosure standards relevant to issuers, to raise the quality of information provided to investors on risks, governance issues and compensation practices.

CONCLUSION

As a responsible investor, the Caisse acts in a fiduciary spirit to provide long-term, risk-adjusted, liability-driven returns to its depositors. In keeping with its mission, philosophy and relationships with actively managed companies, an approach of collaboration and ongoing dialogue with these companies is a success factor that is not measurable in the short term. The Caisse considers that this very approach has yielded tangible results ever since its Policy on Responsible Investment was implemented.